



GASB White Paper: Why Governmental Accounting and Financial Reporting Is—and Should Be—Different

Executive Summary

Governments are fundamentally different from for-profit business enterprises in several important ways. They have different purposes, processes of generating revenues, stakeholders, budgetary obligations, and propensity for longevity. These differences require separate accounting and financial reporting standards in order to provide information to meet the needs of stakeholders to assess government accountability and to make political, social, and economic decisions. Although state and local governments in the United States have had separate standards for over 100 years, occasionally the question is raised: Why can't general purpose governments (cities and counties, for example) simply apply the standards established for business enterprises?¹ The following questions and answers briefly address that issue, and the accompanying paper and its appendixes provide an expanded discussion.

Why Are Separate Accounting and Financial Reporting Standards Essential for Governments?

Separate accounting and financial reporting standards are essential because the needs of users of financial reports of governments and business enterprises differ. Due to their unique operating environment, governments have a responsibility to be accountable for the use of resources that is significantly different from business enterprises. Although businesses receive revenues from a voluntary exchange between a willing buyer and seller, governments obtain resources primarily from the involuntary payment of taxes. Taxes paid by an individual taxpayer often bear little direct relationship to the services received by that taxpayer. Overall, taxpayers collectively focus on assessing the value received from the resources they provide to government. Governmental accounting and financial reporting standards aim to address this need for public accountability information by helping stakeholders assess how public resources are acquired and used, whether current resources were sufficient to meet current service costs or whether some costs were shifted to future taxpayers, and whether the government's ability to provide services improved or deteriorated from the previous year.

The longevity of government and its role to maintain and enhance the well-being of citizens through the provision of public services also result in information demands that differ from those of business enterprises. For example, governments do not operate in a competitive marketplace, face virtually no threat of liquidation, and do not have equity owners. Consequently, information on fair values of capital assets is of limited value and measures of net income and earnings per share have no meaning to users of governmental financial reports. Instead, users need information to assess the government's stewardship of public resources, including information to evaluate the manner and extent to which resources are devoted to specific services and the costs of providing those services. Users

also need information to determine compliance with legally authorized spending authority. Creditors of both businesses and governments are interested in information on the ability to repay debt. However, government creditors focus more on information regarding the government's ongoing ability to raise taxes and the costs of activities that could compete for those resources, rather than on information about how earnings are generated.

How Do Existing Accounting and Financial Reporting Standards Reflect the Different Needs of Stakeholders?

The needs of the users of governmental financial reports are reflected in differences in the components of the conceptual framework for accounting standards and in individual accounting standards. Although investors and creditors are important constituencies of every standards-setting organization, the Governmental Accounting Standards Board's (GASB) conceptual framework also places priority on addressing the informational needs of citizens and elected representatives, two constituencies not identified as users of business enterprise financial statements by the Financial Accounting Standards Board (FASB). Consequently, the GASB's financial reporting objectives consider public accountability to be the cornerstone on which all other financial reporting objectives should be built.

Some of the most significant GASB standards that address differences in governmental and business financial reporting include (1) the measurement and recognition of certain types of revenues (for example, taxes and grants), (2) the view that capital assets provide services to citizens rather than contribute to future cash flows, (3) the use of fund accounting and budgetary reporting to meet public accountability needs, (4) the use of accountability principles rather than equity control to define the financial reporting entity, and (5) the treatment of pensions and other postemployment benefits to allocate cost of services equitably to applicable periods. These and other accounting and reporting differences are described more fully beginning on page 11 and in Appendix B.

Why Is There an Ongoing Need to Set Additional Governmental Accounting Standards?

Since its inception in 1984, the GASB has strived to meet the needs of the users of governmental financial reports by issuing a number of important standards. Although the GASB has made progress, the need to develop and improve accounting standards for governments still exists. For example, additional components of the conceptual framework, which enhances consistency in setting government standards, are still being addressed. In addition, there are many important types of transactions, such as those associated with derivatives and intangible assets, for which there are no existing standards or for which existing standards are not comprehensive. The GASB's research agenda also includes, for example, a project to address additional ways to communicate results of government activities. Finally, over time governments and the governmental environment continue to change, resulting in an ongoing need to update existing standards and to adopt new standards.

¹The term *business enterprise* is used to refer to private-sector entities organized for the purpose of earning profit. Business enterprises in the United States apply accounting pronouncements of the Financial Accounting Standards Board. *Business enterprise* does not refer to and should not be confused with business-type activities of governments.